CHAPTER II. THE SIZE, ALLOCATION, AND USES OF FEHB RESERVES

The federal government now holds about 80 percent of the $490 million in total FEHB reserves, and individual participating insurance carriers hold the remainder. This chapter analyzes the levels and allocation of the reserves, focusing on the two government-wide plans. It also examines the possible disposal of excess FEHB funds.

HOW LARGE A RESERVE IS NECESSARY?

Whereas reserve funds are considered an acceptable hedge against adverse cost fluctuations, no specific level of FEHB reserves has been uniformly agreed on for the FEHB program. Thus, various reserve levels have been considered and proposed during the past decade. Review and analysis by the Congressional Budget Office suggest that the present cumulative reserves could reasonably be reduced by almost two-thirds and still offer adequate protection against unexpected cost increases.

According to CBO's comparison of expected and actual costs for Blue Cross/Blue Shield and Aetna during the eight years before 1981, an accumulated reserve (contingency and special combined) equal to 4 percent of total premium income would have been sufficient to cover all but the most extreme shortfall. Other federal agencies, notably the General Accounting Office (GAO), have proposed similarly low reserve levels for the two government-wide plans. GAO has recommended a level of 5 percent. 1/

1/ See General Accounting Office, Opportunities for Improving Administration of Government-Wide Indemnity Benefit Plan of Health Insurance for Federal Employees and Annuitants (1972), p. 45; this study calculated a reserve requirement of 5 percent for the Aetna plan, considering only estimating errors due to statistical chance. In October 1972, the Subcommittee on the Retirement, Insurance and Health Benefits of the House Post Office and Civil Service Committee solicited views from

According to an unpublished analysis prepared by OPM staff members, a combined rate of 5.4 percent of premium income would provide sufficient buildup of reserves for the two government-wide plans. If such a level had been set for calendar year 1980, aggregate reserve requirements would have totaled $118 million, rather than the $368 million that actually accumulated. The OPM analysis based its findings on review of recommendations by various insurance specialists and on the estimated impact of various factors that affect most forecasting--including statistical chance, inflation, and use of health-care resources.

The OPM staff analysis resulted in a schedule of reserve target levels determined by plan size. The targets suggested for plans other than the two government-wide ones range from 5.7 percent of premium income for plans covering more than 500,000 persons to 12.0 percent for plans covering fewer than 20,000 persons. If the reserve schedule had been applied for all FEHB plans in 1980, the target level for combined reserves would have been $183 million (averaging 5.6 percent of premium income), or about one-third of the actual $490 million accumulation.

WHO SHOULD HOLD RESERVES?

While the federal government holds about 80 percent of FEHB excess in contingency reserves, the participating carriers hold the other 20 percent in special reserves. The present dollar allocation is $402 million in contingency reserves and $88 million in special reserves (see Table 3). Both pools serve the purpose of cushioning the system in the event of unforeseen cost variation.

Transferring special reserves to the federal government would be consistent with the financial management objectives governing payments to off-budget organizations in other federal benefit programs. For example, in Medicare, Medicaid, and Aid to

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insurance specialists on appropriate FEHB reserve levels. Recommendations from the four respondents included: 16.7 percent of premium income (Insurance Commissioner, State of Illinois); a 10.0 percent level (Insurance Commissioner, State of Michigan); and a 6 percent level (official of the U.S. Department of Housing and Urban Development and the Wyatt Company, an independent actuarial firm).

TABLE 3. ALLOCATION OF FEHB RESERVES: END OF CALENDAR YEARS 1971-1980, IN MILLIONS OF DOLLARS a/

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Government-Held Reserves	125	149	177	208	202	225	268	323	381	402
Carrier-Held Reserves a/	1	102	61	56	-18 b/	187	300	469	355	88
Total	126	251	238	264	184	412	568	792	736	490
Government-Held Reserves as a Percent of Total	99.2	59.4	74.4	78.8	100.0	54.6	47.2	40.8	51.8	82.0

SOURCE: Derived by CBO from Annual Statistical Publications of the Office of Personnel Management, 1972-1980.

a/ Includes Blue Cross/Blue Shield, Aetna, and all other plans except those that are community based.

b/ Minus figure denotes a loss to carriers.

Families with Dependent Children letters of credit are used as needed to secure federal fund advances for cash disbursements. Such arrangements obviate the need for nonfederal entities to hold cash surpluses and, despite the possibility of higher rates of return, correspondingly increase U.S. Treasury cash balances that reduce the need for Treasury borrowing. 2/ Transferring to the federal government that portion of FEHB reserves now held by participating organizations could achieve the same objectives.

2/ Informal analysis by GAO staff shows little difference over the long-run between rates of return on federally held contingency reserves and on carrier-held special reserves.

Such a reallocation could be accomplished either by participating organizations' making payments to the government or, conversely, by the government's reducing its payments to carriers. The change would be administrative and would not necessitate legislative action.

Shifting special reserves to the contingency accounts that OPM holds might raise carriers' concerns about having easy access to federal funds to cover shortfalls. This concern might be particularly critical to smaller carriers, which tend not to have significant nonfederal resources; some carriers might push for higher premiums as recompense for the shift in reserves. At present, however, access to special reserves may be limited by long-term securities included in the reserve investment portfolios of some insurers. For example, it would not be unusual for nearly half of the FEHB portfolio held by Blue Cross/Blue Shield to consist of securities with maturity periods of one year or more. Thus, carriers' concerns about a change in access may be more relevant for some carriers than for others. In any event, new FEHB procedures for making payments from contingency reserves and experience in other federal programs suggest that tighter controls on cash holdings could be effectively implemented.

DISPOSAL OF EXCESS RESERVES

At present, OPM disposes of excess reserves over two or three years in order to lessen future rate fluctuation. OPM could adopt other practices, however. For example, a more equitable approach might be to confine the use of excess FEHB reserves to the next contract year; this would mean that most of the people benefiting from the disposal of excesses would be people who had contributed to it in the first place.

Even greater equity in the disposal of reserves could be achieved under a system of rebates to plan enrollees. FEHB program managers do not believe a rebate system could be easily implemented, and they express strong concern about making rebates in a timely manner; but enrollees would certainly prefer a delayed rebate than none at all. 3/ Such an approach would require

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3/ Implementation of a rebate system might be more difficult than ordinarily expected in view of cited deficiencies in FEHB operations, including data discrepancies and inadequate use of automated data processing. See General Accounting Office, Errors In Health Benefits Enrollment Data Push Up Health Insurance Costs (December 1979).

legislative amendment, however, and solution of various administrative problems, including changes in FEHB data systems. Giving rebates would also increase operating costs, record keeping, postage, and other overhead expenses. To avoid unintentional supplements to agency operating budgets, new rebate legislation could require that the portion of surplus attributable to agency contributions revert to the general fund of the Treasury.

Offering additional health benefits might also be a way to draw down FEHB reserve excesses. This approach would be more costly than other methods unless the added benefits were cancelled when the excess was used up. To maintain the added benefits after reserve excesses were depleted, future premium rates would have to be raised.

Another method of disposing of excess FEHB reserves would be to transfer all excess sums to the general fund of the Treasury. This approach, also requiring new legislation, would be easy to administer. Such a scheme would prevent outlay increases by denying any benefit to enrollees whose premiums contributed to the excess. Enrollees' objections would be well founded although less relevant for people who have changed health plans or who no longer participate in the FEHB program.

CHAPTER III. OPTIONS FOR CHANGING THE LEVEL AND ALLOCATION OF FEHB RESERVES

According to the Administration's budget estimates of March 1981, OPM plans to maintain FEHB program reserves that will average 20 percent of premium income through fiscal year 1986. The estimates also suggest that OPM will continue to reduce the portion of total reserves held by participating organizations--from 22 percent at the end of fiscal year 1982 to 13 percent at the end of fiscal year 1986.

This chapter presents three policy choices that would change the planned level and allocation of FEHB reserves; they could be implemented, for the most part, either administratively or by Congressional mandate. Three financing changes that would not affect FEHB operating costs are outlined below:

- Option I -- Limit reserve accumulations to present OPM guidelines and require disposal of excess reserves in the next contract year.
- Option II -- Limit reserve accumulations to OPM guidelines, require disposal of excess reserves in the next contract year, and have the federal government hold all reserves.
- Option III -- Impose lower reserve limits, require disposal of excess reserves in the next contract year, and have the federal government hold all reserves.

The discussion of each option covers changes in the allocation and cumulative level of reserves and in the disposal of any excess reserves. Also considered is the impact each option would have on carriers, enrollees, and the federal budget. (To simplify implementation, any of the changes could be limited to the two government-wide plans, although the overall effects would be accordingly smaller.)

Even under the status quo, budget estimates for the FEHB program are subject to considerable uncertainty. Analysis by CBO concludes that the three options discussed here would net cumulative budget outlays through fiscal year 1986 ranging from $85 million to $375 million more than the Administration currently estimates. The outlay changes in CBO's analysis result from how the federal budget reflects the diverse effects of each option on agencies, enrollees, and carriers. These estimated impacts would vary if the Administration were to revise its budget projections for the FEHB program. 1/ (See Tables 4, 5, and 6 for projected effects of options on FEHB outlays, reserve levels and allocation, and premium rates.)

Agencies. In the budget, premium payments to the FEHB trust fund from on-budget agencies have no net impact on total federal budget outlays, because they simply represent internal budgetary transactions. Thus, lowering agency premiums to reduce reserves, an element in each of the options below, would not affect net budget outlays. Exceptions would occur in the case of the U.S. Postal Service and other off-budget federal agencies, for which reduced premiums would increase outlays. (Premium payments from off-budget agencies have a different outlay impact because they are treated as income from external sources that offset budget outlays.)

Enrollees. Under current practice, premium income from enrollees offsets budget outlay totals and is reflected in the FEHB trust fund. Each option would reduce premium income to draw down reserves and would thus increase outlays.

Participating Carriers. Payments to carriers from the FEHB trust fund generate federal outlays. Transferring carrier-held reserves to the federal government, as described in Options II and III, would reduce federal outlays because of decreased payments to carriers.

1/ In the past, Administration estimates have tended to understate the level of accumulated reserves. Examination of budget estimates since 1975, for example, shows that in four out of five fiscal years (1976-1980), actual increases in reserves averaged 3.7 times the increases estimated in the current budget year. Reports for the contract year ending December 31, 1980, however, suggest that the current budget estimates may overstate the level of accumulated reserves.

TABLE 4. ESTIMATED EFFECTS OF FEHB OPTIONS ON FEDERAL BUDGET OUTLAYS: FISCAL YEARS 1982-1986, IN MILLIONS OF DOLLARS

	1982	1983	1984	1985	1986	Cumulative Impact
Outlays Under Current Practice a/						
	2,160	2,410	2,695	3,005	3,330	13,600
		(NET REDUCTIONS UNDER ALTERNATIVES)				
Option I	45	25	25	40	55	190
Option II	30	-5 b/	-35 b/	25	70	85
Option III	170	60	-10 b/	55	100	375

SOURCE: Congressional Budget Office.

NOTES: Estimates are rounded to the nearest $5 million; net reductions represent changes from Administration budget estimates. Appendix Tables B-1, B-2, and B-3 provide detailed information on the outlay impact of each option.

a/ Federal outlays for the FEHB program represent the net flow of cash between the Treasury (FEHB fund and individual agency accounts) and the nonfederal sector (carriers, enrollees, and off-budget agencies). Specifically, the outlays to carriers are offset by receipts from the portion of premiums paid by enrollees and off-budget agencies.

b/ Minus figures denote budget savings.

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OPTION I. Limit Reserve Accumulations to Present OPM Guidelines and Require Disposal of Excess Reserves in Next Contract Year

This alternative is posited on a belief that current guidelines are necessary to yield reserves adequate to cover adverse cost variation, but that a more timely disposition of excess reserves would better benefit the enrollees whose premiums created them. Option I would maintain existing OPM guidelines concerning the targeted level of reserves to be accumulated but would require that all excess accumulations be applied during the next contract year to defray rate increases. In other words, the negotiation of premiums would not anticipate holding excess reserves. In addition, the portion of carrier-held special reserves would gradually

TABLE 5. AVERAGE FEHB RESERVE LEVELS AND ALLOCATION UNDER ADMINISTRATION PROJECTION AND CBO OPTIONS: FISCAL YEARS 1982-1986

	Combined Reserves		Percent Allocation of Reserves	
	In Millions of Dollars	As a Percent of Premium Income	Government-Held Reserves	Carrier-Held Reserves
Administration Projection	1,145	20	83	17
Option I	780	14	83	17
Option II	780	14	100 a/	0
Option III	330	6	100 a/	0

SOURCES: Office of Personnel Management and CBO.

NOTE: Dollar amounts are rounded to the nearest $5 million.

a/ Because of phased implementation, the federal government would hold all reserves by the end of fiscal year 1984.

decline. This approach would be consistent with Administration budget estimates for fiscal years 1982-1986. Opponents point out that accelerated disposition of excess reserves would eliminate a cushion against fluctuation of future rates.

Under this option, the contract negotiations for premium rates for calendar year 1982 would limit the accumulation of total FEHB reserves to the 14 percent average of OPM guidelines--compared to the 20 percent average currently projected by the Administration. The special reserves would still vary according to plan size and type. Consistent with OPM estimates, carriers would hold about 17 percent of all FEHB reserves over the next five years.

Drawing down each year's entire excess during the following year would leave some $540 million to defray premium rates negotiated throughout the next five fiscal years. The portion of reductions benefiting enrollees would total $230 million, but it would average only $12 per capita for each of the next five years.

TABLE 6. FEHB PREMIUM REDUCTIONS UNDER CBO OPTIONS: FISCAL YEARS 1982-1986

	Cumulative Reductions a/ (in Millions of Dollars)			Average Annual Savings Per Enrollee (in Dollars)
	Enrollees	Agencies b/	Total	
Option I	230	310	540	12
Option II	230	310	540	12
Option III	455	630	1,085	23

SOURCE: Congressional Budget Office.

a/ Impacts represent changes from Administration budget estimates. Estimates are rounded to the nearest $5 million.

b/ Estimates include premium reductions for both on-budget and off-budget agencies.

Budget outlay increases of $190 million through fiscal year 1986 include costs of $280 million for the loss of receipts from lower premiums paid by enrollees and off-budget federal agencies, less associated savings of $90 million for maintaining the allocation of reserves reflected in the Administration's five-year budget estimates.

Option I could be modified to dispose of excess funds by means other than premium reductions (described in Chapter II in the section on elimination of excess reserves). Either rebates to enrollees or premium rate reductions would have the same effect on enrollees and budget outlays. Instead, however, excess reserves could be applied to new benefits. Under this approach, the excess reserves would benefit enrollees, but outlay increases over five years would be greater--$450 million instead of $190 million. A third variation could be to legislate a transfer of all FEHB excess reserves to the general fund of the Treasury. Because under this approach no benefit would accrue to enrollees or off-budget agencies, program outlays would not increase.

OPTION II. Limit Reserve Accumulations to OPM Guidelines, Require Disposal of Excess Reserves in the Next Contract Year, and Have the Federal Government Hold All Reserves

In other federal programs, the government seeks to limit the amount of federally earmarked cash held outside the Treasury. Accordingly, Option II would transfer to the federal government the special reserves now held by participating carriers. As with Option I, this alternative would limit total reserve accumulations to OPM's targets--averaging 14 percent of premium income. This plan could be implemented over a three-year period, during which FEHB payments to carriers would decrease, and payments into the government-held contingency reserves would increase by the same amounts. The phase-in period would give carriers time to plan for liquidation of invested assets.

The impact of Option II on overall FEHB reserve levels and premium reductions would be the same as that under Option I. But incorporating a transfer of all carrier-held reserves to the federal government would yield five-year outlay costs of some $85 million--in contrast to the $190 million increase under Option I. The net five-year costs result from increases of $280 million for lower premiums paid by enrollees and off-budget federal agencies and decreases of $195 million for transfer of special reserves.

Five-year outlay savings could reach $195 million if Option II were limited to a transfer of reserves only. Similar savings would result if, by legislative action, excess reserves were transferred to the general fund of the Treasury. If excess reserves were used instead to add benefits, on the other hand, five-year costs could increase to about $345 million.

Participating carriers might oppose this option because of fear that federally held funds would be less accessible, even though special reserves now are partly invested in multi-year securities, and arrangements for ready access to federal holdings could be provided through administrative action or legislation.

OPTION III. Impose Lower Reserve Limits, Require Disposal of Excess Reserves in the Next Contract Year, and Have the Federal Government Hold All Reserves

The most stringent alternative, Option III, would markedly lower reserve target levels. Upon full implementation, total cumulative reserves for all plans would average about 6 percent of premium income. Accumulated reserves for the two government-wide plans would average 5 percent of premium income, and for other plans, they would range from 6 percent to 12 percent of premium income, depending on plan size. As with Option II, this alternative would transfer carrier-held reserves to the federal government.

This option, which would require new authorizing legislation, would provide for short-term Treasury borrowing by the FEHB fund as a backstop to the lower reserve levels. The Treasury advances would be limited to 8 percent of premium income per individual plan, thus providing annual levels of contingency financing (reserves averaging 6 percent plus 8 percent borrowing authority) equivalent to OPM guidelines now set at 14 percent of premium income. The Treasury advances would be repaid, with interest, out of the following year's premiums.

As in the other two options, this alternative would discontinue the practice of holding reserves in excess of OPM targets. Because of its lower reserve requirements (which are consistent with OPM staff, GAO, and CBO analysis), Option III would achieve the greatest premium reductions. Premium savings would amount to $1.09 billion through fiscal year 1986. Of this amount, $455 million would benefit enrollees at an average of $23 per enrollee per year. Because of cost increases of $570 million for reduced enrollee and off-budget agency premiums and cost decreases of $195 million for the transfer of special reserves to the Treasury, Option IV would increase five-year budget outlays by $375 million. Much of the cumulative increase would occur in the first year of implementation. If, as a modification, excess reserves were used to add benefits, the increase in cumulative outlays could reach $890 million.

APPENDIXES

APPENDIX A. SUMMARY DATA ON FEHB PLANS

The analysis in this study is based on data for the two government-wide plans, 12 employee health insurance organizations, and the assorted small group and individual practices that participate in the FEHB program. Enrollment and reserve data on these plans are summarized in Table A-1. The employee organization plans covered are:

American Federation of Government Employees Health Benefit Plan (AFGE)

Government Employees Hospital Association Benefit Plan (GEHA)

National Association of Letter Carriers Health Benefit Plan (NALC)

Postmasters Benefit Plan

Rural Carrier Benefit Plan

Foreign Service Benefit Plan

Government Employees Benefit Association Health Benefit Plan (GEBA)

Panama Canal Area Benefit Plan (Canal Zone)

Special Agents Mutual Benefit Association (SAMBA) Health Benefit Plan

Mail Handlers Benefit Plan

Alliance Health Benefit Plan

American Postal Workers Union Plan (APWU)

TABLE A-1. SUMMARY DATA ON FEHB PLANS: CALENDAR YEAR 1979

Plan	Plan Income (in Millions of Dollars)	Enrollees (in Thousands)	Reserves (in Millions of Dollars) Contingency	Special	Total
		Government-Wide Plans			
Blue Cross/ Blue Shield	1,751.3	1,867	153.9	242.8	396.7
Aetna	341.0	482	107.1	26.5	133.6
Subtotal	(2,092.4)	(2,349)	(261.0)	(269.3)	(530.3)
		Employee Organizations			
AFGE	25.8	30	3.9	1.4	5.3
GEHA	60.2	78	8.9	8.1	17.0
NALC	188.9	177	27.8	12.2	40.0
Postmasters	46.6	43	3.9	-3.3	0.6
Rural Letter Carriers	37.7	38	6.2	5.4	11.6
American Foreign Service	10.5	11	1.4	2.5	3.9
GEBA	5.8	6	.4	-0.5	-0.1
Canal Zone	20.5	20	3.0	5.5	8.5
SAMBA	19.0	19	3.4	5.4	8.8
Mail Handlers	61.1	71	8.3	14.9	23.2
Alliance Health	97.9	107	12.0	-2.7	9.3
APWU	215.4	207	26.5	14.3	40.8
Subtotal	(789.4)	(807)	(105.7)	(63.1)	(168.8)
		Group and Individual Practices			
	81.3	88	14.3	23.2	37.5
GRAND TOTAL	2,963.2	3,244	381.0	355.5	736.5

SOURCES: Derived by CBO from data in U.S. Office of Personnel Management, Federal Fringe Benefit Facts 1980, (preliminary). Number of enrollees taken from the 1979 report.

NOTES: Details may not add to totals because of rounding. Data on community-rated plans are not included; reserves for these plans account for only 4.4 percent of total FEHB program reserves.

APPENDIX B. OUTLAY EFFECTS OF OPTIONS

This appendix provides detailed information on the impacts of each option on total budget outlays and those of the FEHB fund. Detail of premium reductions for enrollees and agencies is also provided. All estimates represent changes from current Administration projections implicit in the March 1981 budget materials.

TABLE B-1. OUTLAY EFFECTS OF OPTION I RELATIVE TO ADMINISTRATION ESTIMATES: BY FISCAL YEAR, IN MILLIONS OF DOLLARS

	1982	1983	1984	1985	1986	Cumulative Effect
Impact on FEHB Trust Fund						
Reduction in payments to plans (-)	-30	-15	-15	-15	-15	-90
Reduction in income from lower premiums	140	80	80	105	135	540
FEHB Total	110	65	65	90	120	450
Impact on on-budget agencies	-65	-40	-40	-50	-65	-260
Net budget impact	45	25	25	40	55	190
Detail for Reduced Premium Income						
From enrollees	60	35	35	45	55	230
From off-budget agencies	15	5	5	10	15	50
From on-budget agencies	65	40	40	50	65	260
Total	140	80	80	105	135	540

SOURCE: Congressional Budget Office.

NOTE: Estimates, rounded to the nearest $5 million, reflect difference between FEHB contract (calendar) year and the federal fiscal year.

TABLE B-2. OUTLAY EFFECTS OF OPTION II RELATIVE TO ADMINISTRATION ESTIMATES: BY FISCAL YEAR, IN MILLIONS OF DOLLARS

	1982	1983	1984	1985	1986	Cumulative Effect
Impact on FEHB Trust Fund						
Reduction in payments to plans to eliminate special reserves (-)	-45	-45	-75	-30	a/	-195
Reduction in income from lower premiums	140	80	80	105	135	540
FEHB Total	95	35	5	75	135	345
Impact for on-budget agencies	-65	-40	-40	-50	-65	-260
Net budget impact	30	-5	-35	25	70	85
Detail for Reduced Premium Income						
From enrollees	60	35	35	45	55	230
From off-budget agencies	15	5	5	10	15	50
From on-budget agencies	65	40	40	50	65	260
Total	140	80	80	105	135	540

SOURCE: Congressional Budget Office.

NOTE: Estimates, rounded to the nearest five million dollars, take into account the difference between the program's contract (calendar) year and the federal fiscal year.

a/ No reduction in payments to plans occurs in this year because administration estimates show no change in special reserve levels between fiscal year 1985 and fiscal year 1986.

TABLE B-3. OUTLAY IMPACT OF OPTION III ON ADMINISTRATION BUDGET ESTIMATES: BY FISCAL YEAR, IN MILLIONS OF DOLLARS

	1982	1983	1984	1985	1986	Cumulative Effect
Impact on FEHB Trust Fund						
Reduction in payments to plans to eliminate special reserves (-)	-45	-45	-75	-30	a/	-195
Reduction in income from lower premiums	410	200	125	160	190	1,085
FEHB Total	365	155	50	130	190	890
Impact for on-budget agencies	-195	-95	-60	-75	-90	-515
Net budget impact	170	60	-10	55	100	375
Detail for Reduced Premium Income						
From enrollees	175	85	50	65	80	455
From off-budget agencies	40	20	15	20	20	115
From on-budget agencies	195	95	60	75	90	515
Total	410	200	125	160	190	1,085

SOURCE: Congressional Budget Office.

NOTE: Estimates, rounded to the nearest five million dollars, take into account the difference between the program's contract (calendar) year and the federal fiscal year.

a/ No reduction in payments to plans occurs in this year because administration estimates show no change in special reserve levels between fiscal year 1985 and fiscal year 1986.